STATEMENT FOR THE RECORD
OF THE
SUBCOMMITTTEE ON AVIATION
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
U.S. HOUSE OF REPRESENTATIVES
BY
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America West Airlines is grateful to share with the Subcommittee its perspective on the airline industry and observations regarding its future. When America West last addressed the Subcommittee, in September, 2001, it was joined by other airlines testifying in the immediate aftermath of September 11, 2001. During that testimony, the industry requested federal government assistance in stabilizing the United States airline industry during a time that it appeared that it might not survive. America West is extremely appreciative to the Chairman, Members of this Committee, and Congress for their bold decisions and leadership in meeting the aviation crisis brought on by the events of 9/11. Because of the strong and decisive actions to swiftly pass the Air Transportation Safety and System Stabilization Act, our nation's air transportation system was stabilized and our country is much stronger.

Air transportation is the engine that drives our nation's economy. Today, the airline industry employs approximately 600,000 people and generates more than $100 billion in annual revenue. Air transportation is the center of America's just-in-time economy, broadly responsible for more than 10 million domestic jobs in the U.S. travel and tourism industry and more than 8 percent of the U.S. GDP. Low cost airlines, like America West, further benefit the economy by reducing the costs of conducting business, which is particularly important to small business and our country's entrepreneurial sector.

While the airline industry continues to struggle today, the current situation does not resemble the aftermath of 9/11. At that time, the entire civil aviation system was just beginning to restart after being shut down for four days. Despite a reduction in industry capacity of approximately 20 percent, America West testified that its flights were only about 35 percent full. Worse, no one could predict with certainty as to when or if Americans would return to the air. In the meantime, airline expenses continued to accumulate at approximately $340 million per day.

The recovery of our nation's air transportation system was understandably slow. Flight schedules were immediately ratcheted down to 70 to 80 percent of pre-9/11 levels, contributing to further losses. Reduced schedules following the attack meant reduced revenues and a longer recovery period. America West did not return to 100 percent of its pre-9/11 schedule until August of 2002.

The industry also testified that the airlines whose aircraft were used in the attacks would be in danger of failure unless their liability was limited and that other carriers could not obtain reasonably priced insurance in the marketplace. And finally, the industry testified that the capital markets were closed to all airlines. This testimony was reinforced by a letter from the investment banking firm, Morgan Stanley, which stated, "Today, there are virtually no markets open to these carriers. The U.S. airline industry has been an industry with enormous need for capital. Today, however, the risks go beyond those that can be analyzed and priced… There will be no functioning capital markets for the U.S. airline industry until the uncertainty with respect to both liquidity and liability are eliminated."

With the benefit of two and a half years of history, clearly the Air Transportation Safety and System Stabilization Act addressed each of these issues effectively and that evidence is summarized below.

- First, by providing $5 billion of immediate relief, the Act offset a portion of the losses incurred by the industry while the system was shut down and until Americans returned to the skies. Today, system load factors are as high as ever as the Act helped to restore consumer confidence in the domestic air system and the airlines. While yields remain too low for the industry to be profitable in aggregate, this is driven by excess industry capacity, not a lack of consumer demand.

- Second, the Act limited claims arising from the terrorist-related aircraft crashes of September 11, 2001, to the limits of the liability coverage maintained by those carriers, and as a result those carriers were able to maintain operations. It also permitted the Secretary of Transportation to reimburse air carriers for a portion of the increase in the cost of war risk insurance. This provision is set to expire on August 31, 2004, but in this case the situation has not materially improved because the War on Terrorism continues. As a result, no reliable and competitive commercial market exists for this insurance. In fact, after 9/11, new insurance quotes reflected increases of as much as $1 billion for the industry. Moreover, the quoted policies severely reduced coverage limits and put in place seven-day cancellation periods. Congress must extend the program to allow U.S. airlines to continue to provide efficient air service at a reasonable cost.

- Third, the Act provided for the issuance of up to $10 billion of loan guarantees to eligible airlines. This provision was designed to provide financing for airlines that could prove they had a viable business plan but simply had no access to capital due to the conditions laid out in the Morgan Stanley letter. The provision was designed to fill a short-term need until the capital markets reopened to airlines and as such set a deadline for applications of June 30, 2002. The Congressional intent of this provision was made clear as stated by then-Chairman Ernest Hollings in the September 20, 2001 hearings of the Senate Commerce, Science & Transportation Committee: "It strikes me that with the attack both in Manhattan and here in Washington, that we, as a Congress or committee, are going to have to decide up front that you are going to have to save the airlines, and once that is made, we have got to have a cut-off point of some kind, because if you do it in a halfway approach,

> it strikes me that we will just get into a limbo year-in and year-out, where we have got to do this to save the airlines. Let us make the formative decision up front, put in a cut-off point, put in what is necessary, and then let us see if they can compete."
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> This provision also served its purpose well. A number of airlines, including America West, were able to obtain loan guarantees and remain operating while the public and private capital markets were closed. Today, the markets clearly have reopened and did so long ago. Since 9/11, U.S. airlines have accessed over $14 billion of financing through the public capital markets, including America West, which raised $86 million in July 2003 through a convertible offering. Thankfully, today any airline that can demonstrate a reasonable chance of repayment has access to financing.

America West Airlines is proud to be a shining example of the success of Congress' actions. In late August 2001, America West had come to agreement with lenders in the private market for a $200 million unsecured loan, but that transaction fell through after 9/11. Without this financing and given the operating environment at that time, America West's future was in danger. With no capital available to airlines at that time, America West became the first airline to apply for a loan guarantee with the Air Transportation Stabilization Board. On January 18, 2002, America West became the first airline to be granted a guarantee.

Without the Act, low-cost airline America West and its 13,000 employees might not be in existence. And while some of America West's competitors may not view our survival as a particularly positive event, that disappointment is primarily due to the fact that the America West model has proven to be successful. Because of the Act, America West not only survived the immediate crisis, it has returned to profitability and indeed, has established itself as a positive force in the industry. America West is one of only four airlines to report a profit in each of the last four quarters and it continues to grow and create more jobs. America West plans to add 1,000 additional employees during 2004, and the majority of those positions will be line pilots, flight attendants, fleet service and customer service positions.

Consumers continue to benefit from America West's presence. Not only has America West saved the traveling public hundreds of millions of dollars per year in the form of lower fares, taxpayers are receiving significant returns on their investment. As part of the loan, the government received warrants to purchase America West stock that, if exercised today, would generate approximately $130 million of profit. And America West has already begun to repay its loan; in March 2004, it made its first principal payment of $43 million. The airline has also made three annual guarantee fee payments associated with its loan that total over $100 million.

Clearly the aggressive steps taken by Congress immediately following 9/11 ensured our industry's survival. But along with those actions, in 2003, Congress reviewed government's responsibility for security costs and passed the Emergency Wartime

Supplemental Appropriations Act. This Act granted carriers a total of $2.4 billion for expenses and revenue forgone related to aviation security.

- This included a provision for $100 million in reimbursement for the government mandate to strengthen flight deck doors.
- The Act reimbursed airlines for some passenger security and air carrier security fees paid to or collected by the Transportation Security Administration.
- Finally, this Act provided a four-month waiver of the Security Fee for the period beginning June 1, 2003, and ending September 30, 2003.

Since security is a government responsibility and an expense not borne by other modes of transportation (trucks, buses, railroads), these were, in America West's view, entirely appropriate provisions.

Additionally, America West notes that Congress took particular care when creating legislation immediately following 9/11 as well as during 2003 to ensure all airlines were treated fairly. In the 2001 Stabilization Act, grants were allocated to airlines based on their flown available seat miles during August 2001. Also in that Act, any domestic airline could apply for a government-backed loan by June 30, 2002. America West applauds the care taken to ensure government aid was equitably distributed.

Although extremely grateful for the vital role the federal grant and loan program played in the industry's recovery and in America West's survival, America West knew that simply accepting government assistance would not be enough to secure its long-term success. Indeed, the airline engaged in a major self-help strategy designed to adapt its business model to the new reality.

While its costs have always been, on average, lower than most airlines, America West took aggressive steps after 9/11 to lower costs even further by:

1. Renegotiating aircraft leases in light of the new environment, saving over $60 million annually;
2. Reducing staffing, including a 20 percent reduction in senior management positions, saving nearly $20 million annually;
3. Closing its Columbus hub, which was a painful, but nonetheless necessary, decision, and one that saved approximately $25 million annually. It is noteworthy that America West is the only airline to have taken the aggressive step of eliminating a hub since September 11, 2001;
4. Eliminating free inflight meal service and becoming the first airline to experiment with buy-on-board food, significantly reducing advertising/promotion expenses, and decreasing additional distribution costs, all of which took another $60 million out of its cost structure.
5. Increasing the utilization of its assets. America West's aircraft utilization was amongst the highest in the industry in the first quarter at 10.8 hours per day, up 7 percent versus the prior year.

These actions have allowed America West to reduce its already low unit cost structure to one of the lowest in the airline industry. For the full year 2000, America West's cost per available seat mile (CASM) was 8.56 cents, as compared to an industry average CASM of nearly 10.47 cents. For the first quarter 2004, the airline's CASM was 7.59 cents, as compared to an industry average CASM of nearly 9.71 cents. Despite already being a low-cost carrier prior to 9/11, America West's unit cost improvement between 2001 and first quarter 2004 is among the industry's most improved. Even more significant, this was accomplished without imposing wage reductions on its employees or having any employees on furlough.

All of this simply demonstrates that part of America West's core competency has always been to operate efficiently and with a low cost structure. When the economic reality of the airline industry changed after September 11, 2001, the America West team did not sit still simply because it was already a low-cost airline. Instead, it reinvigorated its efforts to ensure it had a cost structure in place that would achieve long-term viability in a new world.

Cost reduction, however, is only half of the story at America West. In response to changing consumer demand and increased price sensitivity among business passengers, America West announced a radical new pricing structure in March 2002. This new, simplified structure reduced business fares 40 to 70 percent and eliminated restrictive fare rules like Saturday night stay requirements. This consumer friendly fare action was described by one Wall Street analyst as “potentially the single most important pricing move of the last decade.” The new structure has increased America West’s share of high yielding business passengers and reduced its reliance on lower yielding wholesale traffic. Business traffic now constitutes over 40 percent of America West’s business, compared to approximately 30 percent prior to its fare structure change.

Recently, America West introduced its new fare structure to traditional, high priced markets like the transcontinental nonstop flights between some of the nation’s largest airports. With high-cost competitors now matching America West’s fares in these new markets, America West estimates consumers currently save about $350 million annually in these transcontinental markets alone.

Given its successful transformation, and when queried by others as to how to fix the problems our industry faces, America West believes that, in aggregate, there is excess capacity in the industry and costs are too high. There are too many airplanes, too many networks, and too many hubs. In addition, taxes, fees, and mandated costs are far too high. The industry will continue to struggle so long as this situation exists. Increased demand from an improving economy will be insufficient to correct this imbalance. At this point in time, both government and industry must be willing to let the markets work.

America West acknowledges that it is ironic for an airline that survived due to a federal loan guarantee to declare that the market should be allowed to work. However, America West firmly believes the circumstances of the government assistance offered immediately following 9/11 are dramatically different than what the industry faces today. In the immediate aftermath of 9/11, Congress needed to stabilize an industry that was rocked by an act of war so that the free market could again take hold. Because of the bold steps taken by passing the Stabilization Act, the free market has taken hold, and now should be allowed to take its course.

Letting the free market work does not mean there is no role for the Congress. Congress needs to help ensure that airline costs are held down. That means ensuring that the industry is not overtaxed and non-reimbursable mandates are not adopted. The Statement for the Record by the Air Transport Association of America (ATA) describes our industry's taxation problem well and America West is fully supportive of the ATA's Statement.

The original purpose of taxes and fees in the airline industry was to build a closed loop for financing the costs of maintaining the air transportation system. To accomplish this, in 1973, there were only three taxes. By 1992, the number of taxes and fees had grown to nine. These taxes also were beginning to be used to cover expenses not related to transporting passengers, such as customs, immigration, and agricultural inspection fees. Today, the litany of taxes and fees on airlines and their passengers has grown to fifteen and now includes huge expenditures for security.

Since 1991, the tax burden has tripled. The customer now pays up to 28.4 percent on a $200 round trip ticket. For low cost airlines the situation is worse. Taxes and fees can make up 23 percent of the cost of an average ticket in the America West system. Aviation taxes have outpaced inflation and airfares, and have grown faster than airline labor costs and the consumer price index. Consider, too, that these increases have occurred during a period in which the average price of an airline ticket has actually decreased.

One of the largest areas of increased taxation is a result of growing federally mandated security requirements, taxes and fees. Air carriers are now shouldering in excess of $3.8 billion in cost/taxes/fees related to security and the Administration is actually proposing a $435 million increase in this amount. Other programs that have contributed to additional costs for the industry include increased security costs for baggage and catering, costs associated with employee background checks and fingerprinting, additional search and inspection training costs and other flight crew defensive training costs. No other U.S. industry subsidizes national security like the airline industry. By comparison, other transportation industries, such as truckers, shippers, railroads, buses, and automobiles, pay the federal government nothing for additional security programs put into place after 9/11. The free market is seriously distorted when airlines are forced to pay taxes that alternative modes of transportation are not. It is time for the Administration and Congress to acknowledge that aviation security is a national defense issue and to begin funding it as such.

Further, unlike the availability of capital markets, there is no reliable and competitive commercial market for private war risk insurance. War risk insurance legislation needs to be reauthorized by Congress.

Lastly there are fundamental, free market issues that continue to limit smaller, newer airlines' ability to grow and prosper. These include barriers to entry such as lack of gates or antiquated perimeter rules, which should be eliminated. Airport access is particularly crucial as our industry consolidates.

Conclusion

America West again commends the Congress for the bold and aggressive steps taken by passing the Air Transportation Stabilization and Security Act. The Act allowed the industry to stabilize, and therefore ensured terrorists did not win the battle against our country's transportation system. Americans have returned to the skies, driving both business and leisure travel. The capital markets are again open to any airline with a business plan that projects a reasonable chance of repayment.

As we move forward, we would simply ask that Congress allow the free market to work and not pick winners and losers. As consolidation happens, ensure that barriers to entry for low cost carriers are removed. Government's role should be to reduce our already extremely high tax burden by recognizing that airline security is a national defense issue and funding it as such. Congress should ensure that no additional taxes or unfunded mandates are imposed upon our already overburdened industry.

Both government and industry learned many lessons on September 11, 2001. America West believes we must continue to build upon this knowledge base to ensure our skies are safe and our nation’s transportation system sets the appropriate tone for our country’s economic recovery and long-term strength.